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SUBJECT: ROMANIA: BURGEONING BUDGETARY BLUES

REF: BUCHAREST 920 AND PREVIOUS

Classified By: Charge d'Affaires Jeri Guthrie-Corn for Reasons 1.4 (B) and (D).

11. (SBU) As negotiations among the political parties over the shape of a new coalition government enter their second week, the economic news in Romania is a study in contrasts. Eurostat announced on December 5 that Romanian GDP growth reached 9.1 percent in the third quarter (July-September), the highest level in the EU by a wide margin and a Romanian record for quarterly growth in the post-Communist era. At the same time, the Government of Romania (GOR) announced a series of urgent cost-cutting measures to rein in end-of-year spending in the face of a serious cash flow crunch that has U.S. and other companies complaining over unpaid bills and which portends further budget troubles ahead.

12. (SBU) Romania's very high 3rd quarter growth virtually assures that, even with a 4th quarter slowdown, total GDP growth for 2008 will exceed eight percent. Still, the cash flow crisis facing the GOR is stark illustration that, at least in some sectors of the economy, the transition from boom to bust has been very rapid. In a December 6 press interview, Minister of Economy and Finance Varujan Vosganian said that very tight conditions in credit markets and slowing economic activity in certain sectors, such as heavy manufacturing, were creating serious cash flow problems for many companies. They in turn are passing those problems on to the GOR by delaying tax payments, resulting in a revenue shortfall of nearly five billion lei (1.5 billion euros, or about 1 percent of GDP) below expected levels in October and November, Vosganian said. (NOTE: While firms are assessed penalties for late tax payments, many are apparently concluding that this is cheaper than high-priced commercial credit, assuming such credit is even available at all.) While government revenues in 2008 have grown more than 30 percent over 2007 levels, spending has risen even faster. The big drop-off in GOR revenues has coincided precisely with the GOR's customary late-year spending surge exacerbated by populist measures in the run-up to the November 30 parliamentary elections. Tax revenues have become "decoupled" from GDP growth, Vosganian observed.

13. (C) Vosganian insisted to the press that the GOR is taking measures to keep the 2008 fiscal deficit below the politically sensitive level of three percent of GDP (one of the Maastricht criteria for entrance into the euro zone). However, a senior economic adviser to Prime Minister Calin-Popescu Tariceanu admitted to post's EconCoun last week that the three percent level was surpassed at the end of November and the final deficit will likely be closer to four percent, or even higher. Adviser Razvan Orasanu said the GOR is only able to fund current spending at the rate it can raise money through T-bill auctions in the domestic market,

and even though the latest 90-day issues are paying around 14.25 percent, subscriptions have been slightly below GOR expectations. As a result, the government post-elections is seeking to cut expenditures any way it can; the Prime Minister has made a show of ordering cutbacks in everything from official travel to newspaper subscriptions and chauffeured cars for top officials. End-of-year holiday bonuses traditionally paid to all government workers will this year be restricted only to "meritorious" employees (with the usual lack of transparency as to who exactly will qualify for this).

14. (C) Such trimming around the margins will have only a minor impact, however, so the GOR has bigger targets in its sights. On December 4 the Cabinet issued an emergency ordinance postponing implementation by one year of additional pension hikes for retirees in certain "hard labor" categories (such as former miners); the law was to have entered into force on January 1, 2009 and came on top of a 20 percent general pension increase granted in October. The postponement will save the GOR about 550 million euros, but affected pensioners have vowed to push the new Parliament to overturn the decision. Meanwhile, several major U.S. companies have complained to post that the GOR is intentionally withholding value-added tax (VAT) refunds owed since the summer or is not paying installments on contracts for work performed; the arrears in some cases total tens of millions of euros. PM adviser Orasanu said he sympathized with these companies but insisted that "the treasury is empty;" the GOR will not release major VAT reimbursements until at least the end of January, he said.

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15. (C) Comment. GOR officials are publicly sanguine about their budget woes -- Vosgianian said companies in tax arrears should be able to return this "fiscal credit" to the GOR in early 2009 -- but the hard truth is that, in just a few short weeks, GOR finances appear to have gone over a cliff. Vosgianian insisted that the GOR would meet all its December obligations with regards to salaries, pensions, official debt servicing, and payments to the EU. Even some of these fundamental obligations may be at risk, however. Former Education Minister Cristian Adomnitei told post's PolCoun last week that he believes the ministry may not be able to sustain salary payments to teachers through the end of the month (a real irony in light of the new law, now postponed until March, granting teachers a 50 percent wage hike). With the current government headed for the exits, all the spending decisions -- and cuts -- made in this flurry of activity will be subject to revision by the new parliament and government. Romanians can only hope the new leadership is more adept at managing the budget, because the government which a short while ago was seemingly awash in cash now suddenly appears to be high and dry. End comment.
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